

Part III

Administrative, Procedural and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.

(Also Part I, §§ 442; 1.442-1)

Rev. Proc. 2003-62

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SECTION 1. PURPOSE

.01 This revenue procedure provides the exclusive procedure under § 442 of the Internal Revenue Code and § 1.442-1(b) of the Income Tax Regulations for individuals within its scope filing federal income tax returns on a fiscal year basis to obtain automatic approval to change their annual accounting period to a calendar year. This revenue procedure **modifies, amplifies, and supersedes** Rev. Proc. 66-50, 1966-2 C.B. 1260, and modifies and supersedes Rev. Proc. 81-40, 1981-2 C.B. 604. An individual that complies with all of the applicable provisions of this revenue procedure will be deemed to have established a business purpose and to have obtained the approval of the Commissioner of Internal Revenue to change the individual's annual accounting period to a calendar year under § 442 and the regulations thereunder.

SECTION 2. BACKGROUND

.01 Taxable Year Defined.

(1) *In general.* Section 441(b) and § 1.441-1(b) (1) provide that the term "taxable year" generally means the taxpayer's annual accounting period, if it is a calendar or fiscal year, or, if applicable, the taxpayer's required taxable year.

(2) *Annual accounting period.* Section 441(c) and § 1.441-1(b) (3) provide that the term "annual accounting period" means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes its income in keeping its books.

.02 Change in Taxable Year.

(1) *In general.* Section 1.442-1(a) (1) generally provides that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain the approval of the Commissioner.

(2) *Annualization of short period income.* Section 443(b) and § 1.443-1(b) (1) (i) generally provide that if a return is made for a short period resulting from a change of an annual accounting period, the taxable income for the short period must be placed on an annual basis by multiplying the income by 12 and dividing the result by the number of months in the short period. Unless § 443(b) (2) and § 1.443-1(b) (2) apply, the tax for the short period generally is the same part of the tax computed on an annual basis as the number of months in the short period is of 12 months. Section 443(c) generally requires a similar adjustment to the deduction for personal exemptions.

(3) *No retroactive change in annual accounting period.* Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in annual accounting period.

.03 Approval of a Change. Section 1.442-1(b) provides, in part, that in order to secure the approval of the Commissioner to change an annual accounting period, a taxpayer must file an application, generally on Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, with the Commissioner within such time and in such manner as is provided in administrative procedures published by the Commissioner. In general, a change in annual accounting period will be approved if the taxpayer establishes a business purpose for the requested annual

accounting period and agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the change.

.04 *Special Rule for Newly Married Couples.* Section 1.442-1(d) provides a special rule under which a newly married husband or wife may obtain automatic approval to change his or her annual accounting period in order to use the annual accounting period of the other spouse so that a joint return may be filed for the first or second taxable year of that spouse ending after the date of the marriage. Generally, this change is made by filing a federal income tax return for the short period, and not by filing a Form 1128.

SECTION 3. SIGNIFICANT CHANGES

Significant changes to Rev. Proc. 66-50, as modified by Rev. Proc. 81-40, include:

.01 Section 4.01 of this revenue procedure provides that this revenue procedure is the exclusive procedure for individuals within its scope to automatically change their annual accounting period to the calendar year;

.02 Section 4.02 of this revenue procedure does not limit the scope of this revenue procedure to individuals who receive only certain listed types of income;

.03 Section 4.02(2) of this revenue procedure retains the general rule of Rev. Proc. 66-50 that precluded the use of the automatic change procedures by individuals deriving income from interests in pass-through entities, but provides that interests in pass-through entities will be disregarded in certain circumstances;

.04 Section 6 of this revenue procedure conforms the terms and conditions applicable to annual accounting period changes by individuals under this revenue procedure to those of: Rev. Proc. 2002-37, 2002-1 C.B. 1030, as clarified and modified by Notice 2002-72, 2002-46 I.R.B. 884, and as modified by Rev. Proc. 2003-34, 2003-18 I.R.B. 856; Rev. Proc. 2002-38, 2002-1 C.B. 1037, as clarified and modified by Notice 2002-72; and Rev. Proc. 2002-39, 2002-1 C.B. 1046, as clarified and modified by Notice 2002-72 and as modified by Rev. Proc. 2003-34. These terms and conditions include:

- (1) a limitation on the carryback of net operating

losses over \$50,000 or general business credits that are generated in the short period; and

(2) a requirement that certain related entities concurrently change their annual accounting period to the new calendar taxable year of the individual owner; and

.05 Section 7.02 of this revenue procedure extends the due date for filing a Form 1128 under this automatic revenue procedure to the due date of the individual's federal income tax return (including extensions) for the first effective year, as defined in section 5.03.

SECTION 4. SCOPE

.01 *Applicability.* Except as provided in section 4.02, this revenue procedure, which is the exclusive procedure for individuals within its scope, applies to an individual requesting automatic approval to change the individual's annual accounting period to a calendar year.

.02 *Inapplicability.* This revenue procedure does not apply to:

(1) *Newly married couples subject to § 1.442-1(d).* An individual that is permitted to change to the annual accounting period of the individual's spouse under § 1.442-1(d). See section 2.04 of this revenue procedure.

(2) *Interest in a pass-through entity.* An individual that has an interest in a pass-through entity as of the end of the short period. However, an interest in a pass-through entity will be disregarded for this purpose if any of the following conditions are met:

(a) the pass-through entity would be required under the Code or regulations to change its taxable year to the new calendar taxable year of the individual (or, if applicable in the case of a controlled foreign corporation (CFC) to a taxable year that begins one month earlier than the new calendar taxable year of the individual). See section 6.07 of this revenue procedure for a special term and condition related to this exception;

(b) the pass-through entity is a fiscal-year partnership that is owned equally (50-percent) by two partners, one or both of whom are individuals, and the individual and the partnership both want to change to the calendar taxable year of the other 50-percent partner. See section 6.07 of this revenue procedure for a special term and condition related to this exception;

(c) the new calendar taxable year of the individual would result in no change in, or less deferral (as described in § 1.706-1(b)(3)) of income from the pass-through entity than the present taxable year of the individual. If the pass-through entity is a partnership, CFC, or foreign personal holding company (FPHC), the individual should compare the existing deferral period (between the pass-through entity's and the individual's current taxable years) with the new deferral period (between the new required year of the pass-through entity and the individual's new calendar taxable year). See section 4.04 of this revenue procedure for an example of this rule; or

(d) for pass-through entities not qualifying for the exceptions in section 4.02(2)(a), (b), or (c) of this revenue procedure, the pass-through entity in which the individual has an interest has been in existence for at least three taxable years and the interest is *de minimis*. For this purpose, an interest in a pass-through entity is *de minimis* only if, for each of the prior three taxable years of the individual:

(i) the amount of income (including ordinary income or loss, capital gain or losses, rents, royalties, interest, dividends, and deduction equivalent of credits) from such pass-through entity is less than or equal to the lesser of (A) 5 percent of the individual's gross income (without adjustments) from all sources for those taxable years, or (B) \$500,000; and

(ii) the amount of the individual's gross income (without adjustments) from all such pass-through entities is, in the aggregate, less than or equal to the amounts described in (A) and (B) above. See section 4.04 of this revenue procedure for an example of this rule.

.03 *Nonautomatic Changes*. Individuals that are not eligible to obtain automatic approval for a change in accounting period under this revenue procedure, applicable regulations, or any other published administrative procedures, must secure prior approval from the Commissioner for a change in annual accounting period pursuant to § 442 and the regulations thereunder. See Rev. Proc. 2002-39.

.04 *Example*. (i) F, an individual having a taxable year ending June 30, wants to change F's taxable year to the calendar year. F has interests in the capital and profits of five partnerships, IJK, LMN, OPQ, RST, and UVW. All of the partnerships have been in existence for at least three taxable years. F's interest in IJK is greater than 50 percent. IJK uses a majority interest taxable year of June 30. F's interest in LMN

is 50 percent; the other 50 percent interest is owned by G, an individual filing federal income tax returns on a calendar year basis. LMN also wants to change its taxable year to a calendar year. LMN uses a June 30 taxable year under the least aggregate deferral rules of § 1.706-1(b)(3). F's interests in OPQ, RST, and UVW are 15 percent, 10 percent, and 5 percent, respectively. OPQ uses its majority interest taxable year under § 706(b)(4), which ends May 31; RST and UVW each use their respective majority interest taxable years under § 706(b)(4), which end December 31. F's distributive share of income/(loss) from OPQ for each of the prior three taxable years is \$5,000, \$(1,000), and \$2,000, respectively. F's gross income for each of those same taxable years from all sources was \$150,000.

(ii) F's interests in F's pass-through entities will be disregarded only if each pass-through entity satisfies one of the exceptions enumerated under section 4.02(2) of this revenue procedure. F's interest in IJK may be disregarded under the exception in section 4.02(2)(a), because F is the majority interest partner in IJK. F's interest in LMN may be disregarded under the exception in section 4.02(2)(b), because both F and LMN are changing to the calendar taxable year, which is the taxable year of individual G, the other 50 percent partner. F's interests in RST and UVW may each be disregarded under the exception in section 4.02(2)(c), because F's new taxable year would result in less deferral than F's old taxable year (a new deferral period of 0 months as compared to the prior deferral period of 6 months from December 31 and June 30). Because F is not the majority interest partner in OPQ, and because F's new taxable year would not result in less deferral from this partnership, F's interest in OPQ may be disregarded only if the *de minimis* exception in section 4.02(2)(d) is satisfied. In this case, the income from OPQ for each of the prior three taxable years was less than the lesser of: (A) 5 percent of F's total gross income from all sources ($\$150,000 \times 5\% = \$7,500$); or (B) \$500,000. Consequently, F's interest in OPQ may be disregarded under the *de minimis* exception in section 4.02(2)(d). Because all of F's pass-through interests are disregarded under section 4.02(2), F is eligible to change under this revenue procedure.

SECTION 5. DEFINITIONS

The following definitions apply solely for the purpose of this revenue procedure:

.01 *Individual*. In the case of married individuals, for any year in which a husband and wife file separate federal income tax returns, the term "individual" includes only the husband or wife who is applying to change his or her annual accounting period under this revenue procedure. For any year in which a husband and wife file a joint federal income tax return, the term "individual" includes both spouses, even if only one spouse is applying to change an annual accounting period under this revenue procedure.

.02 *Pass-through Entity*. For purposes of this revenue procedure the term "pass-through entity" means a partnership; a trust; an estate; a common trust fund (as defined in § 584); a CFC (as defined in § 957), but only if the individual is a U.S. shareholder (as defined in § 951(b)); an FPHC (as defined in § 552), but only if the individual is a U.S. shareholder (as defined in § 551(a)); a passive foreign investment company (PFIC), but only if the individual has elected to treat such PFIC as a qualified electing fund (as defined in § 1295); and a closely-held real estate investment trust (as defined in § 6655(e)(5)(B)), but only to the extent the individual is described in § 6655(e)(5)(A).

.03 *First Effective Year*. The first effective year is the first taxable year for which a change in annual accounting period is effective. Thus, in the case of a change, the first effective year is the short period required to effect the change. The first effective year is also the first taxable year for complying with all the terms and conditions set forth in this revenue procedure necessary to effect the change in annual accounting period.

.04 *Short Period*. An individual's short period is the period beginning with the day following the last day of the old taxable year and ending with the day preceding the first day of the new taxable year.

SECTION 6. TERMS AND CONDITIONS OF CHANGE

.01 *In General*. A change in annual accounting period filed under this revenue procedure must be made pursuant to the terms and conditions provided in this revenue procedure.

.02 *Short Period Tax Return*. The individual must file a federal income tax return for the short period required to effect

a change in annual accounting period by the due date of that return, including extensions, pursuant to § 1.443-1(a). The individual's taxable income for the short period must be annualized and the tax must be computed in accordance with the provisions of §§ 443(b) and (c), and §§ 1.443-1(b) and (c).

.03 *Record Keeping.* The books of the individual (records reflecting income adequately and clearly on the basis of an annual accounting period) must be closed as of the last day of the first effective year.

.04 *Subsequent Year Tax Returns.* Returns for subsequent taxable years generally must be made on the basis of a full 12 months ending on the last day of the new calendar taxable year, unless the individual secures the approval of the Commissioner to change that taxable year.

.05 *Creation of Net Operating Loss.* If the individual generates a net operating loss (NOL) in the short period required to effect a change in annual accounting period, the individual may not carry the NOL back, but must carry it over in accordance with the provisions of § 172, beginning with the first taxable year after the short period. However, except as otherwise provided in the Code or regulations, the short period NOL must be carried back or carried over in accordance with § 172 if it is either: (a) \$50,000 or less, or (b) less than the NOL generated for the full 12-month period beginning with the first day of the short period. The individual must wait until this 12-month period has expired to determine whether the individual qualifies for the exception in (b) above.

.06 *Creation of General Business Credits.* If there is an unused general business credit or any other unused credit generated in the short period, the individual must carry that unused credit forward. An unused credit from the short period may not be carried back.

.07 *Concurrent Change for Related Entities.* If an individual's interest in a pass-through entity is disregarded pursuant to section 4.02(2) because the related entity will be required to change its taxable year to the individual's new calendar taxable year (or, if applicable, in the case of a CFC, to a taxable year beginning one month earlier than the individual's new taxable year), the related entity must change its taxable year concurrently either under Rev. Proc. 2002-37 or

Rev. Proc. 2002-38, whichever is applicable. The related party is required to change notwithstanding the testing date provisions in § 706(b)(4) or 898(c)(1)(C)(ii).

SECTION 7. GENERAL APPLICATION PROCEDURES

.01 *Approval.* Approval is hereby granted to any individual within the scope of this revenue procedure to change the individual's annual accounting period, provided the individual complies with all the applicable provisions of this revenue procedure. Approval is granted beginning with the first effective year. Individuals granted approval under this revenue procedure to change their annual accounting period are deemed to have established a business purpose for the change to the satisfaction of the Commissioner.

.02 *Filing Requirements.*

(1) *Where to file.* An individual who wants to change the individual's annual accounting period pursuant to the provisions of this revenue procedure must complete and file a Form 1128 with the Director, Internal Revenue Service Center, Attention: ENTITY CONTROL, where the individual files the individual's federal income tax return. No copies of Form 1128 are required to be sent to the national office. The individual also must attach a copy of the Form 1128 to the individual's federal income tax return filed for the short period required to effect the change.

(2) *When to file.* A Form 1128 filed pursuant to this revenue procedure will be considered timely filed for purposes of § 1.442-1(b)(1) only if it is filed on or before the due date (including extensions) for filing the federal income tax return for the short period required to effect such change.

(3) *Label.* In order to assist in the processing of the change in annual accounting period, reference to this revenue procedure must be made a part of the Form 1128 by either typing or legibly printing the following statement at the top of page 1 of the Form 1128: "FILED UNDER REV. PROC. 2003-62."

(4) *Signature requirements.* The Form 1128 must be signed by the individual. If an individual is treated as including the husband and wife under section 5.01 of this revenue procedure, the Form 1128 must be signed by both the husband and the wife.

(5) *No user fee.* A user fee is not required for an application filed under this revenue procedure and, except as provided in section 8.01 of this revenue procedure, the receipt of an application filed under this revenue procedure generally will not be acknowledged.

SECTION 8. REVIEW OF APPLICATION

.01 *Service Center Review.* A Service Center may deny a change of annual accounting period under this revenue procedure only if: (a) the Form 1128 is not filed timely, or (b) the individual fails to meet the scope or any term and condition of this revenue procedure. If the change is denied, the Service Center will return the Form 1128 with an explanation of the reason for the denial.

.02 *Review of Director.* The appropriate director may ascertain if the change in annual accounting period was made in compliance with all the applicable provisions of this revenue procedure. Individuals changing their annual accounting period pursuant to this revenue procedure without complying with all the provisions (including the terms and conditions) of this revenue procedure ordinarily will be deemed to have initiated the change in annual accounting period without the approval of the Commissioner. Upon examination, an individual that has initiated an unauthorized change of annual accounting period may be denied the change. For example, an individual may be required to recompute the individual's taxable income or loss in accordance with the individual's former taxable year.

SECTION 9. EFFECTIVE DATE AND TRANSITION RULE

.01 *Effective Date.* This revenue procedure generally is effective for all changes in annual accounting periods for which the first effective year ends on or after July 7, 2003. However, if the time period for filing Form 1128 with respect to a taxable year set forth in section 7.02(2) of this revenue procedure has not yet expired, an individual within the scope of this revenue procedure may elect early application of the revenue procedure by providing the notification set forth in section 7.02(3) on the top of page 1 of Form 1128 and by satisfying the other procedural requirements of section 7.

.02 *Transition Rule.* If an individual within the scope of this revenue procedure filed an application with the national office and the application is pending with the national office on July 7, 2003, the individual may obtain approval under this revenue procedure. However, the national office will process the application in accordance with the authority under which it was filed, unless by the later of August 21, 2003, or the issuance of the letter ruling granting or denying approval for the change,

the individual notifies the national office that the individual wants to use this revenue procedure. If the individual timely notifies the national office that the individual wants to use this revenue procedure, the national office may require the individual to make appropriate modifications to the application to comply with the applicable provisions of this revenue procedure. In addition, any user fee that was submitted with the application will be refunded to the individual.

SECTION 10. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies, amplifies, and supersedes Rev. Proc. 66-50, 1966-2 C.B. 1260, and modifies and supersedes Rev. Proc. 81-40, 1981-2 C.B. 604.

DRAFTING INFORMATION

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